Financial intelligence
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The Context

November 12th 2018

Inside this week's edition…

Know The Flows - China And Japan Equity Funds Continue To Find Support While Europe Funds Struggle

By Cameron Brandt, Director, EPFR Research

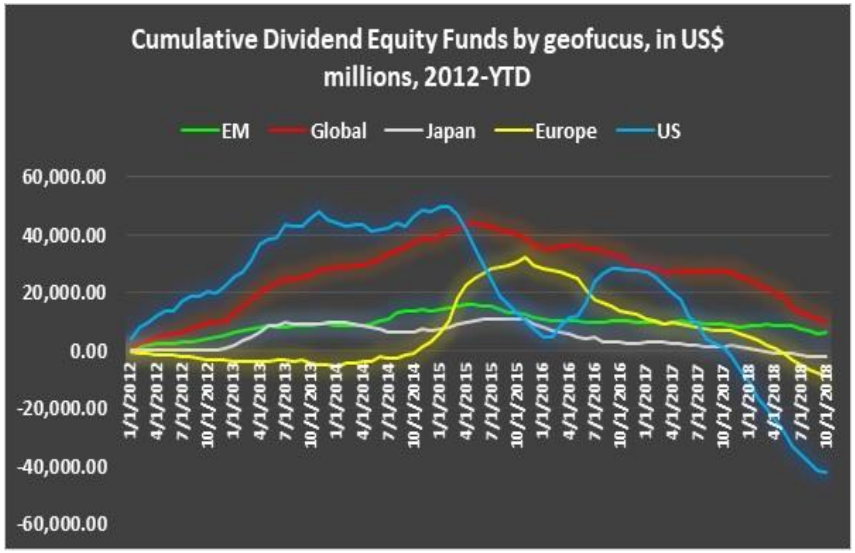
Back to Index Page

With the US mid-term elections and the US Federal Reserve's second-to-last meeting of 2018 on the horizon, investors found little reason during the first week of November to break out of the cautious, Asia-centric pattern they have been following since early October. Japan and China Equity Funds recorded inflows either side of the $2 billion mark and US Bond Funds with short term mandates enjoyed another strong week while Europe Bond Funds extended their longest outflow streak since 4Q11 and Europe Equity Funds recorded their ninth consecutive outflow.

Hopes – that were realized – of a return to divided government in the US, with both major parties able to check the worst excesses of the other and perhaps exercise a degree of restraint on President Donald Trump when it comes to trade barriers, prompted some emerging markets investors to move beyond China. The diversified Global Emerging Markets (GEM) Equity Funds recorded their biggest weekly inflow since the second week of April. Funds with global mandates also fared better, with Global Equity Funds snapping their longest outflow streak since 2Q13 and Global Bond Funds posting their biggest inflow since mid-July.

Overall, the week ending November 7 saw EPFR-tracked Equity Funds take in a net $3.5 billion while Bond Funds absorbed $5.4 billion and Money Market Funds over $36 billion. With interest rates predicted to rise again late this year, US Dividend Equity Funds posted outflows for the 39th time this year while fears of slower growth and tighter monetary policy helped extend Europe Dividend Equity Funds current 23-week redemption streak.

At the asset class and single country fund levels, Municipal and Inflation Protected Bond Funds extended their longest outflow streaks since 4Q16 and 4Q14 respectively and redemptions from Total Return Bond Funds since the start of July topped the $21 billion mark. Brazil Equity Funds recorded their biggest inflow in 33 weeks, flows into Portugal Equity Funds climbed to an eight-week high, Vietnam Equity Funds posted their



largest outflow in over three years and redemptions from Japan Bond Funds hit levels last seen in 1Q15.

With the peak of the US third quarter earnings season behind them and the US mid-term elections ahead, sector investors moved cautiously during the week ending November 7. Flows for the 11 major Sector Fund groups tracked by EPFR ranged from an outflow of $399 million from Real Estate Sector Funds to an inflow of $262 million for both Healthcare and Industrial Sector Funds.

Technology Sector Funds posted their fourth outflow in the past five weeks as speculation about increased taxation and tighter regulation continued to swirl around the sector. But flows into China Technology Sector Funds hit a year-to-date high despite the greater scrutiny that many richly valued Chinese players are attracting and the more challenging economic environment they are operating in.

Banxico's November Rate Decision Looks Set To Be A Close Call

By Natalie Rivett, Senior Emerging Markets Analyst, & Ed Blake Chief FI Technical Analyst

Back to Index Page

October was characterised by near-broad EM FX weakness amid the global stock sell-off, concern over the Fed's tightening path and an escalation in the US-China trade war. The Mexican Peso bore the brunt of the pressure, falling more than 8% against the USD as the country's assets all suffered their worst monthly performance since the surprise election of US President Donald Trump in 2016. This followed incoming President Lopez Obrador's decision to scrap the partially built Mexico City airport in which billions of Dollars have already been invested, after an informal referendum organised by his party.

The decision to cancel the construction of the new airport has helped to erase all the optimism aligned to the recent, successful renegotiation of NAFTA by casting a cloud over Mexico's investment environment and economic growth. Fitch has already cut Mexico's credit outlook to negative in response, citing the persistence of downside risks to the incoming administration's fiscal stance and risks that follow-through on previously approved reforms will stall.

This is evident in the CFTC IMM positioning data for the week ended 30th October, which showed a third straight week of deteriorating investor sentiment towards the MXN as net longs moderated sharply, to 34.1k, the lowest figure since mid-September. During this latest reported week, specs cut almost 18k long contracts to 9.4k (weakest since last week of July) and added 6.1k to outright shorts, to 59.6k (see following dashboard).

EPFR data also highlights a turn in investor sentiment, with a deterioration in Mexican Bond fund flows for the last week of October, which helped to turn YTD cumulative flows marginally net negative. Mexican Bond Fund flows were net negative again in the latest recorded week, ended November 7th. Meanwhile, YTD cumulative flows for Mexican Equity funds dipped below the USD2bn mark in October for the first time in 6-months. That said, for the final week of that month flows conversely turned mildly net positive and for the first time since early September. Net flows were even greater in the first week of November.

The turnaround in the weekly flows back in September incidentally ties in with the prior period of deterioration in long MXN positions (this can be seen in the third graph on the following dashboard). Presumably, on these two occasions, investors have used the weaker Peso to buy into stocks.

What does this mean for Banxico's policy path?

Banxico's November 15th policy meeting has taken on greater significance given recent Peso weakness, by raising the prospect the central bank will resume monetary policy tightening after pausing at 7.75% for the prior two meetings in June and August.

We have seen a handful of banks predicting a 25bp hike (to 8.00%) this month, in line with the consensus estimate from the latest Citi survey of economists, released earlier last week. The market implied policy curve has also moved to price in a quarter point increase and with a further 40bp+ of hikes seen out to 6-months. This marks a turnaround since the beginning of October, when the market was expecting steady policy into year-end, and an easing cycle to commence within a year.

However, USD/MXN has eased from little over four-month highs near 20.500 last week and if the MXN sees some stabilisation next week, ahead of the Banxico meeting, it may take some pressure off the Central Bank to tighten policy. This may in turn be reflected in the short-end of the MIPR curve over the coming sessions. Some analysts have argued that the recent Peso weakness is not enough to prompt Banxico into action.

Thus, the November rate decision looks set to be a close call and will ultimately depend on how great board members consider the threat of persistently high inflation to be. Recall, at the October meeting only one board member, Ramos-Francia, called for a 25bp hike, citing the 'high degree of persistence' of core inflation. However, Governor Diaz De Leon has voiced concern that energy prices could rise in the coming months, making it harder to bring inflation towards target.

Cont. Page 4

Banxico's November Rate Decision Looks Set To Be A Close Call

Back to Index Page

Cont. Page 6

Banxico's November Rate Decision Looks Set To Be A Close Call

Back to Index Page

We would not be surprised if another steady rate decision transpires this month should the MXN avoid a further sell-off, though would argue that the central bank could just be delaying the inevitable and may well leave the Peso open to renewed weakness, sending USD/MXN clear of its recent highs near 20.500. The following technical chart suggests there is scope for an advance to the YTD high of 20.961.

In our opinion, upside risks to inflation (headline was running at 4.89% y/y in October) and the potential for a delayed convergence to the 3% target provide sufficient reason to deliver a 25bp increase this month. Our current projection is for 50bp of hikes within the next six months and with little scope for monetary policy loosening into 2019-end in the event of any fiscal slippage from the new government and should the Fed keep hiking interest rates.

A 25bp rate hike from Banxico may help to stabilise the Peso at firmer levels, though as such an outcome appears largely priced in, 19.500 could prove a tough level to break for USD/MXN in the absence of any broad pick-up in EM risk appetite.

With any improvement in the Peso into year-end we could expect to see a pick-up in long MXN positioning and there is also perhaps the potential for at least a short-lived deterioration in Mexican Equity Fund flows. Stronger borrowing costs could also weigh further on Mexican Bond Fund flows, particularly if the central bank keeps the door open to more tightening.

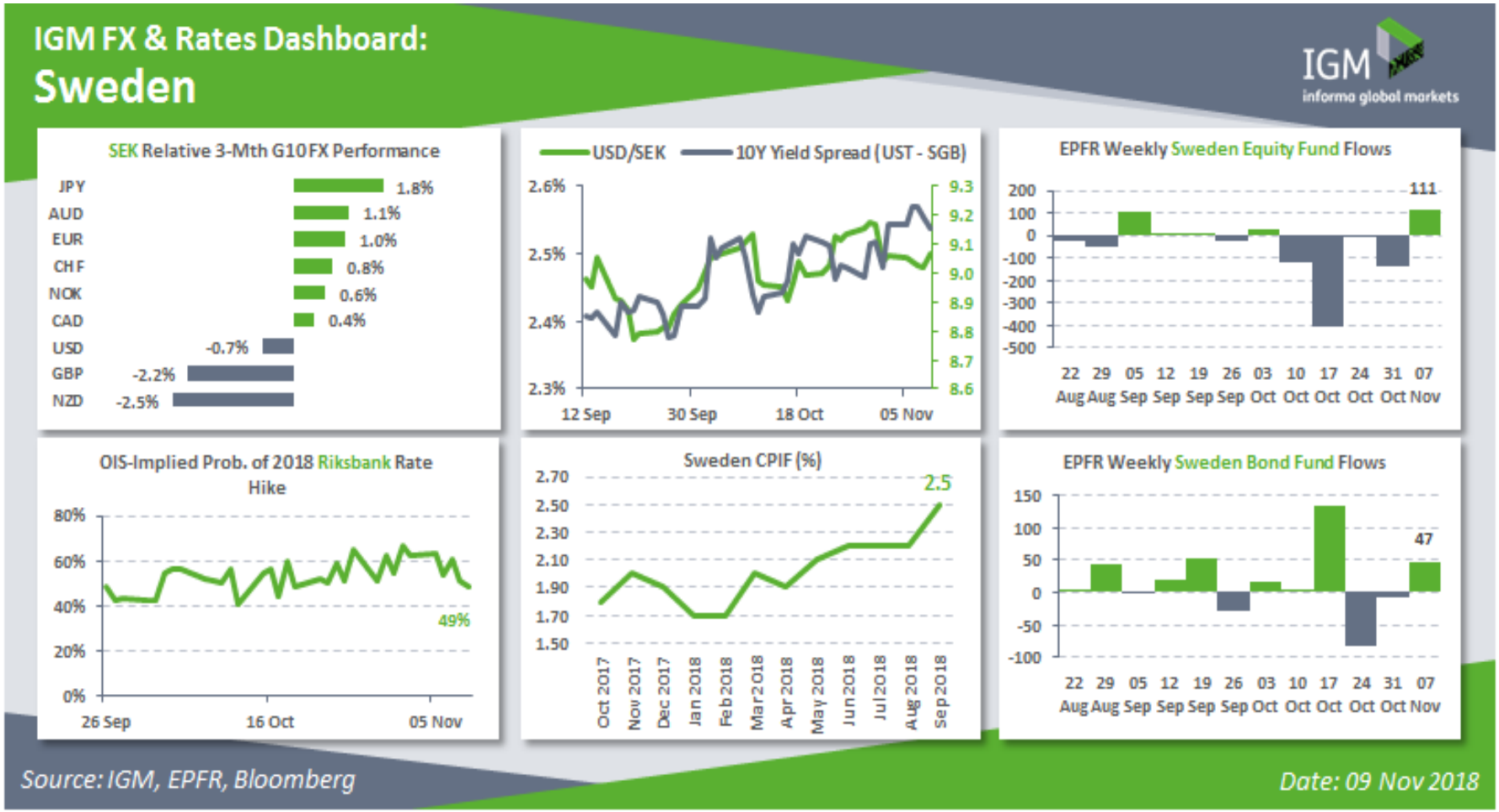
From a technical perspective, the USD/MXN outlook is constructive with 20.609-20.961 eyed next:

- Rebounds strongly from Wednesday's 19.577 corrective low to retrace most of the recent correction from 20.472 (31 October, four-month high)
- Firming studies suggest an eventual clearance opening two-month rising channel resistance at 20.609, perhaps 20.961 (2018 high - 15 June)
- Only a return below Thursday's 19.818 low would caution and risk 19.577

Krona Specs Await Key Inflation Figures

By Rachel Bex, IGM Senior FX Analyst and Andy Dowdell, IGM FX Technical Analyst

Back to Index Page



Cont. Page 8

Krona Specs Await Key Inflation Figures

Back to Index Page

It has been evident this week that Krona investors are in desperate want and need of something to trade off, which certainly explains the somewhat overzealous reaction to latest comments from Riksbank Governor Ingves, who recently repeated that rates will rise at the December or February meet.

More constructive rhetoric over the inflation outlook appeared to be the catalyst for a fresh Sek rally however, with Ingves conceding that "strong activity in Sweden and abroad is creating favourable conditions for inflation to stay close to the target in the coming years", in turn easing some fears that the CB might have been swayed to deliver a "one and done" hike at the turn of the year before slipping back into neutral mode.

Ingves added that "a great deal of support has been required for a long time to bring inflation back to the 2% target", while hawkish CB board member Floden, who voted to hike rates at the October meeting, pointed out that "inflation has returned to being close to target and confidence in the target has strengthened", adding "this now makes it possible to take a step away from the most expansionary policy".

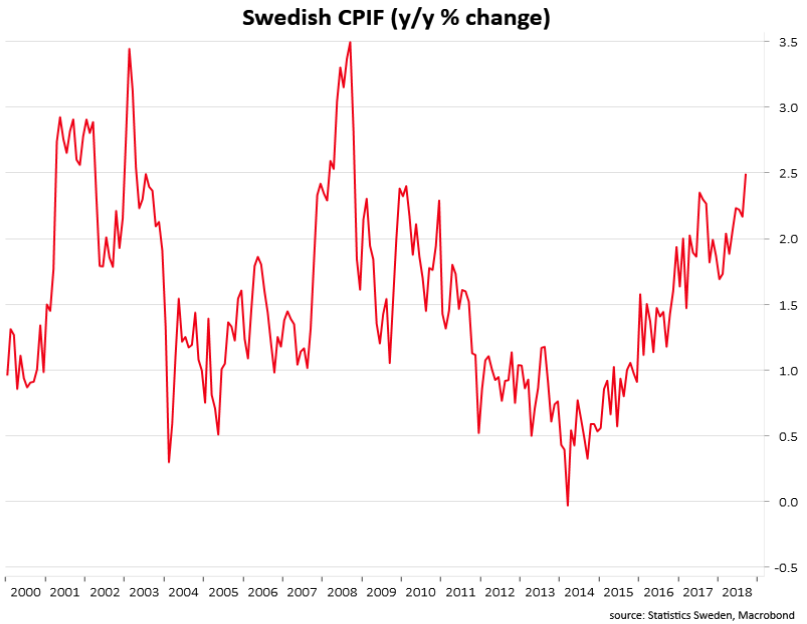
Plenty of analysts/investors received the comments in a positive light, with various banks now believing the Riksbank sounds more confident.

Furthermore, the comments were presumably made in full knowledge of the downwardly revised five year inflation expectations via the latest Prospera survey, meaning the upbeat signals were deemed even more encouraging.

As such, EUR/SEK has fallen to levels not seen since late July, hitting 10.2457 so far.

So, with focus clearly on inflation, the November 14th CPI data will be crucial for near term price action in the Krona, as well as going some way to help decide if a hike will occur this side of 2019.

The key CPIF is forecast to rise to 2.6% y/y from 2.5% y/y last - well above the 2.0% target and roughly in line with the Riksbank's own forecasts. But even small surprises in the data could be enough to rattle these markets eagerly searching for something to trade off.



For now, specs seem intent on pressing the downside in Eur/Sek, although anything sub-expectations could spark another 10.40+ return as exasperated bears lose their resolve once again.

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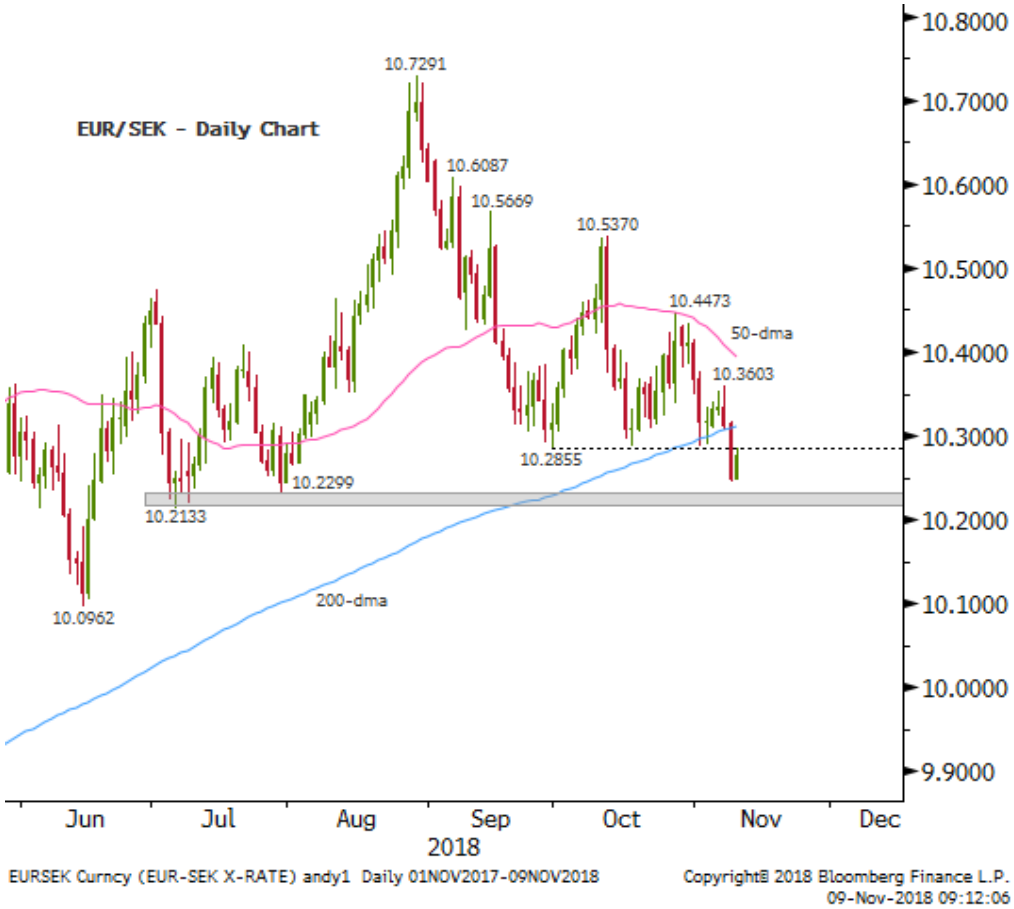
Krona Specs Await Key Inflation Figures

Back to Index Page



- Threatening to rollover after breaching the 200-Day MA/ September-October 10.2855 prior floor on Thursday.
- Bears now eyeing the Jul 10.2299/10.2133 reaction lows, below which would bring the Jun 10.0962 swing low into focus.
- However, an early return above 10.3603 (7 Nov high) would signal a false breakout, paving the way back to 10.4473 (26 Oct high) initially.

Focus Back On 'Neutral' And Fed Balance Sheet Implications

By Marcus Dewsnap, IGM Head of Fixed Income Strategy

Back to Index Page

Two major risk events out of the way, US Midterms and the November FOMC, fundamentals and data return to more prominence. With the former, policy paralysis and Gridlock is the consensus, but as we wrote HERE, do not count out bi-partisan moves on an infrastructure spending Bill. Such fiscal largesse will loosen fiscal policy and therefore impact the Fed (faster hikes than currently priced?), particularly if the FOMC believes it will increase the chances and depth of 'overheating'. Nothing yet to move the CB off course from once a quarter until at least 'neutral' which 10-year USD OIS suggests is just north of 3% Fed Funds. The 1-year swap curve suggests Terminal Funds in the 3.2-3.4% range (restrictive?).

With this in mind, the Fed chief's speech (Wednesday, Thursday he talks about Hurricane Harvey recovery efforts) will be uppermost in investors' minds. The talk is on domestic and global economic issues with Q&A. This brings opportunity to hear/question about subjects not in the FOMC statement, such as recent market volatility (investors searching for any indication of a 'Powell Put' and what might trigger), and Fed balance sheet dynamics. Excess reserves continue to fall, the issue is if/when this will produce scarcity to the extent to hurt the domestic banking system.

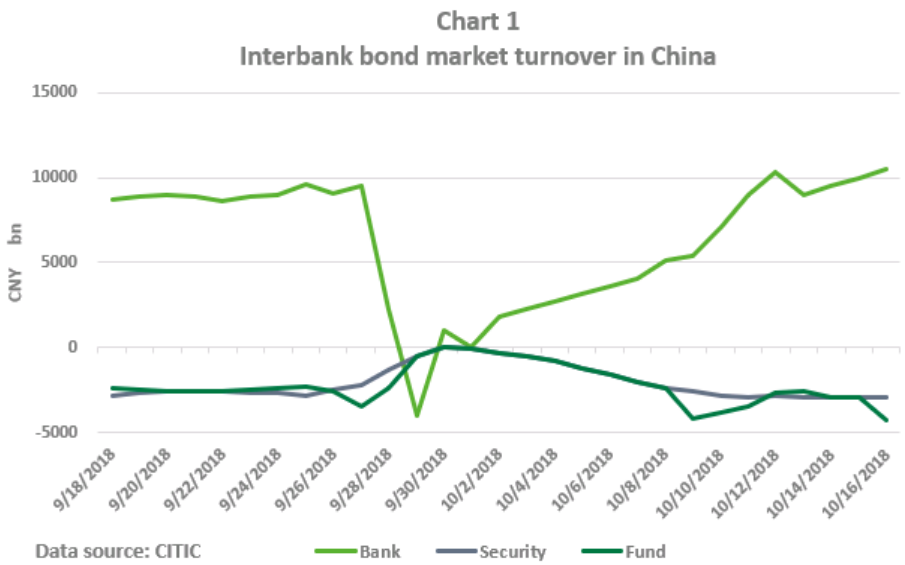
China Insight: Commercial Banks Regain Their Appetite For Onshore Bonds

By IGM's Tim Cheung, Head of China and Riki Zhang, EM Analyst

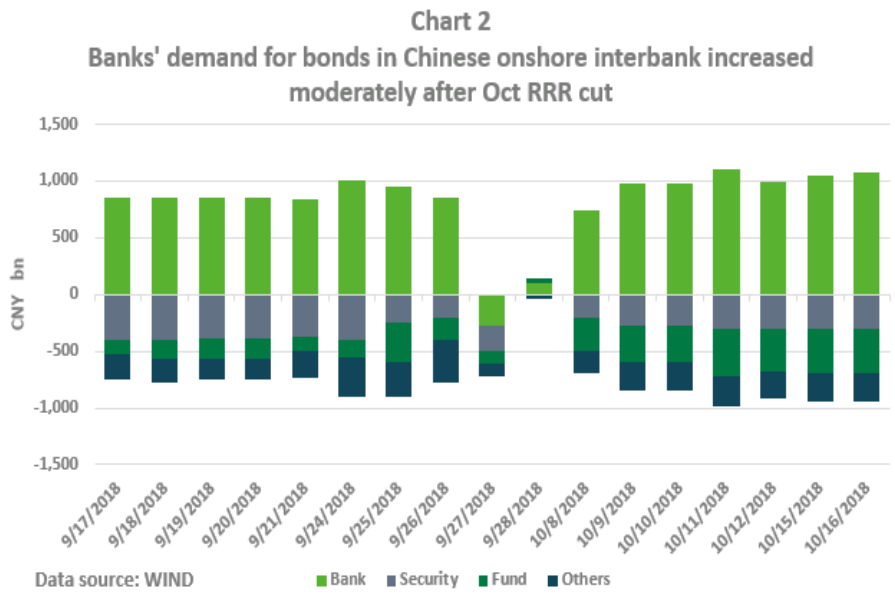
Back to Index Page

China has been loosening its monetary policy stance since the Summer on the back of a slowing economy and escalating US-China trade tensions. Against this backdrop, interbank market participants, which were reducing their bond portfolios during August to September, have started to regain their appetite for Chinese government bonds since the central government's shift towards monetary easing was confirmed by a 100bp RRR cut in early-October.

Chart 1 shows that the bond market turnover contributed by banks has been increasing since early-October.



Meanwhile, Chart 2 shows that banks' demand for bonds in the interbank market rose moderately after the PBoC announced the October RRR cut, despite the fact that the other two types of market participants remained uninterested in buying bonds.



In regards to banks' net demand for interbank funds, we note that it has been in downtrend since August (chart 3).

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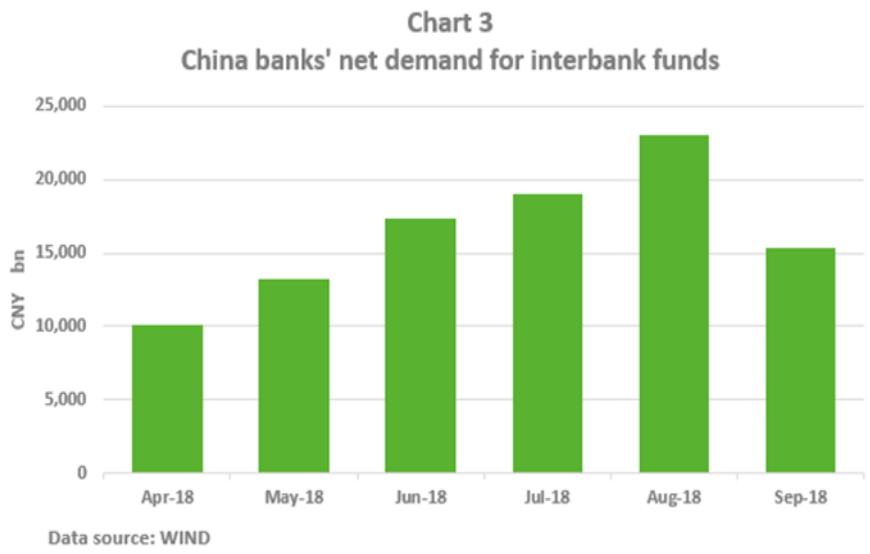
China Insight: Commercial Banks Regain Their Appetite For Onshore Bonds

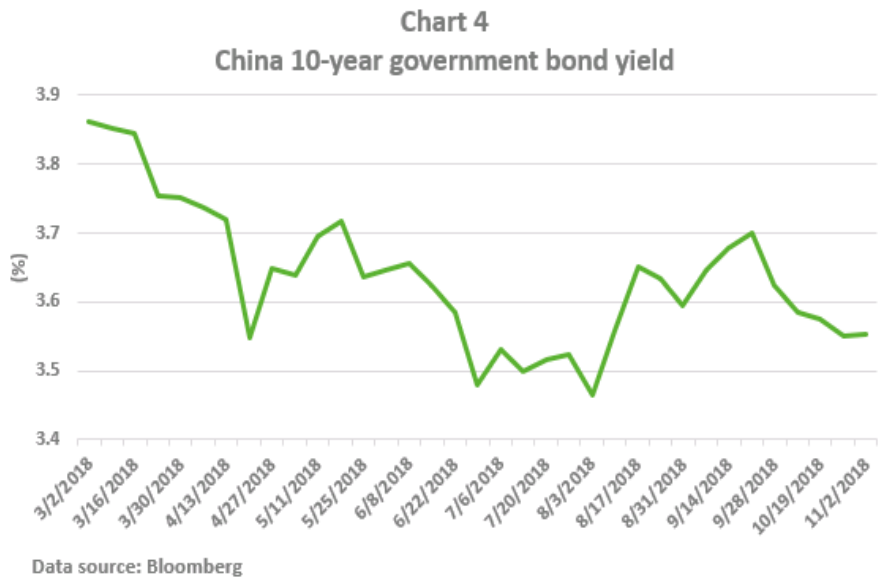
Back to Index Page



In our view, weakening corporates' and individuals' loan demand as a result of a slowdown in the economy is the main cause of a fall in banks' net demand for interbank funds. It is too early to say when demand for loans will recover in response to the loosening monetary stance. Before that happens, banks will probably continue to be keen on investing their surplus funds in bonds. Meanwhile, as long as net demand for interbank funds remains sluggish, there will be not much upside risk for interbank funding costs.

This is obviously supportive of bond prices. As a matter of fact, the MOF 10-year bond yield has been coming off since it topped out at 3.70% in the middle of September (chart 4).

As every policy signal has suggested, an easing cycle has just kicked off in China, we think MOF yields will continue to come off much further over the next few months, with the 10-year yield likely to return to somewhere between 3.00% and 3.20% by the Spring Festival.

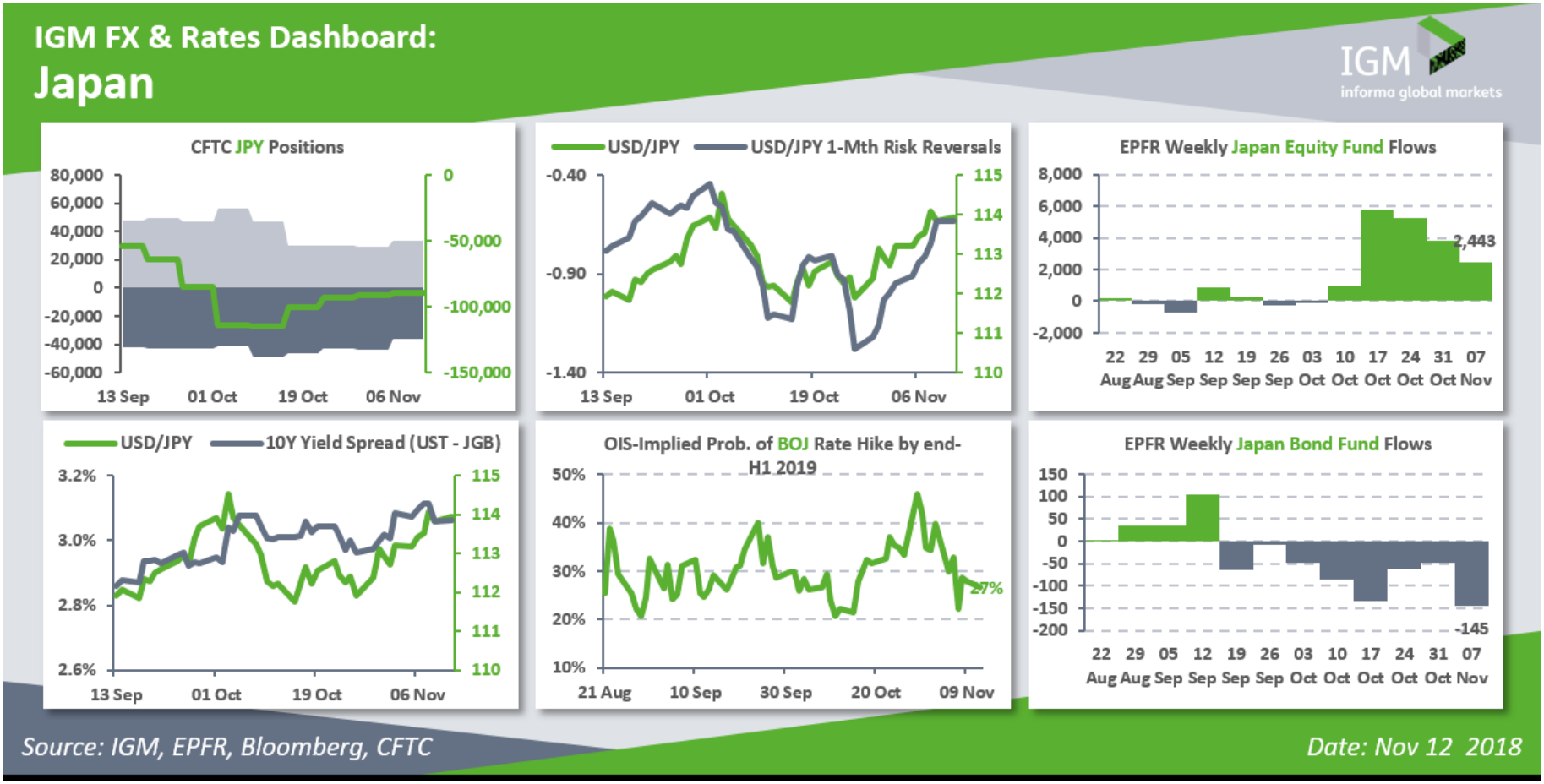


The Yen Week - Bias is Neutral

By IGM's Tony Nyman, Head of G10 FX and Ed Blake, Chief Fixed Income Technical Analyst

Back to Index Page

Expected Usd/Jpy trading range is 113.35/114.45.



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The Yen Week - Bias is Neutral

US data highlights this week promise to be CPI and retail sales Wednesday and they should help underpin those December Fed rate hike expectations (as well as more to come in 2019 too).

Out of Japan, it's Q3 GDP and a -0.3% q/q result forecast versus 0.7% last. If that pans out it would be a softest quarter since Q4 2015. Note Bbg poll extremes are -0.5% and 0.3%.

So, yield differentials to support Usd/Jpy, as the latter does not suggest a need to rush the path of normalisation and the BOJ could well be on hold through 2019 also.

As ever, we'll be keeping an eye on US stocks, in particular. Even though the Reps have lost control of Congress there is speculation that bi-partisan support for infrastructure projects can be achieved and the US pro-growth story can continue into next year. S&P 500 targets of 2815, 2860/65 and 2940/41 record highs are our focus, all still some distance away.

Oil, also, has to be a focus and can Usd/Jpy stay supported with or without Brent recapturing Usd 70/brl-plus near-term at least amid reports of Saudi bemoaning oversupply. Recall MS has indicated this month that the Dollar has converted into an oil currency, vulnerable to lower prices and higher funding costs.

We are long from 112.88, initiated November 2 on a seasonality play (took half profits on the 9th at 113.85) and we are largely still positive.

RISK: Biggest one we fear is broader market risk environment. Fed rate hikes, UK's Brexit worries, EU and Italian budget disagreement, trade conflicts, China and global slowdown etc. It's not a sunny backdrop, which could stoke Yen demand at least on the crosses.

ING look at it slightly differently. The Dutch bank suspects the risk backdrop does hold up this month, which could mean the Yen as preferred funding currency for EM growth plays. They target, on balance, 114.50, but express concern about a possible 7.00 test in Usd/Rmbs.

Back to Index Page

JPY Curncy (Japanese Yen Spot) Graph 3 Daily 09NOV2015-12NOV2018 Copyright© 2018 Bloomberg Finance L.P. 12-Nov-2018 10:47:59

- Builds from 111.38 (26 October low, 7-1/2 month rising channel support and near 100DMA) to retrace much of the prior fall from 114.55 (2018 high - 4 October)
- Firming studies suggest a clearance opening 114.73 (6 November 2017 peak) then 115.10 (.618 projection of 104.56/113.17 from 109.78)
- Only below last Wednesday's 112.95 low and then 112.56 (2 November higher low) would caution and re-open 111.38.

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We will highlight the most compelling on these pages.

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BTP Yield – Minor Pullback Before The Broader Recovery Resumes

Technical Analysis by Ed Blake

Back to Index Page

- The long-term yield recovery reached 3.808 (19 October, 4¾ year high), before easing to range over 3.259 (29 October low)
- A deeper short-term correction cannot be ruled out towards 3.133/3.006, before the broader uptrend resumes
- Longer-term studies remain constructive and should underpin an eventual return above 3.808
- Potential would then be seen to 3.883 (1.618 of 1.033/2.423 projected from 1.633), perhaps 3.945 (27 January 2014 high)

STRATEGY SUMMARY

Buy dips in yields as we favour an uptrend resumption targeting 3.808, possibly 3.883/3.945. Stop under 3.006.

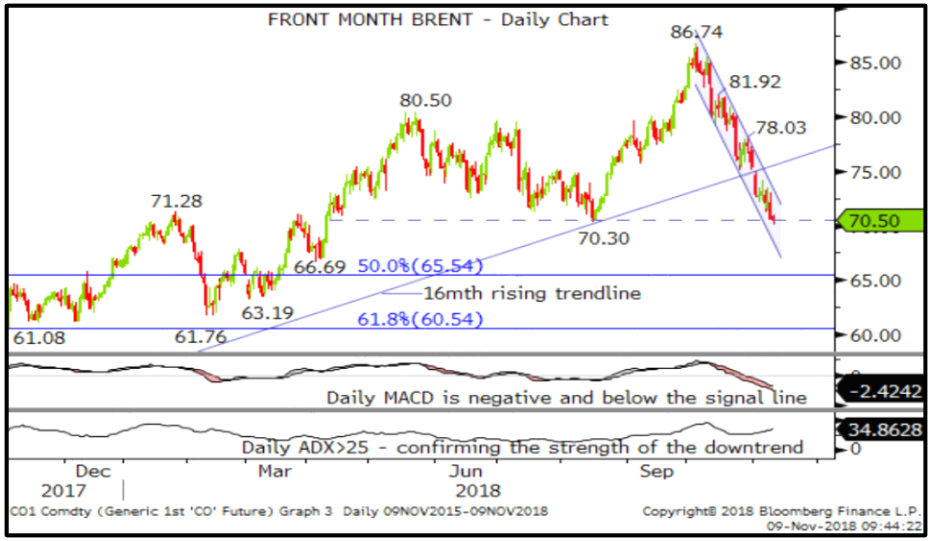
Resistance Levels		
R5	3.945	27 January 2014 lower high
R4	3.883	1.618x 1.033/2.423 projected from 1.633
R3	3.808	2018 peak - 19 October, the highest for 4¾ years
R2	3.638	24 October 2018 high
R1	3.501	30 October 2018 high
Support Levels		
S1	3.259	29 October 2018 low, nr 31 August 2018 high (3.246) and a six-month rising trendline (3.133)
S2	3.006	38.2% retracement of 1.709/3.808 rally
S3	2.752	18 September 2018 higher low, just under 50% retrace of 1.709/3.808 rally at 2.759
S4	2.456	18 July 2018 higher low, just under 61.8% retrace of 1.709/3.808
S5	2.345	28 May 2018 low

BRENT (Front Month) – Decisively below 70.30 would signal a 7mth top

Technical Analysis by Ed Blake

Back to Index Page

- Channelled down from 86.74 (2018 high - 3 October) through a 16-month rising trendline to probe key support at 70.30 (15 August low)
- Studies are weak and a decisive break marks a seven-month top and risks 66.69/65.54 (4 April low/50% retracement of 44.35/86.74 rally)
- Sustained easing exposes the 60.54/61.76 cluster (historic lows, 61.8% retracement of 44.35/86.74 and a 34-month trendline)
- Only a failure to hold under 70.30 delays, but bulls will struggle at 75.52/78.03 (trendline/recent high)



STRATEGY SUMMARY

Sell into any near-term gains as we await a sustained break under 70.30 opening 65.54/66.69, possibly lower. Place a protective stop over trendline resistance at 75.52

Resistance Levels		
R5	87.94	29 October 2014 lower high, near 1.382x 27.10/58.37 projected from 44.35 at 87.57
R4	86.74	2018 high, 3 October – the highest for four years
R3	81.92	15 October minor lower high
R2	78.03	29 October minor lower high
R1	75.52	16-month rising trendline
Support Levels		
S1	66.69	4 April 2018 minor higher low
S2	65.54	50% retrace of 44.35/86.74 rally
S3	63.19	1 March 2018 minor higher low
S4	61.76	2018 low - 13 February
S5	60.54	61.8% of 44.35/86.74, near 11 November 2017 low (61.08) & 34mth trendline (61.13)

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